

— HEARING PANEL REPORT —

ADDRESSING THE ABILITY OF HANDLERS AND OF PRODUCERS TO ENTER AND LEAVE THE POOL (DEPOOLING) BASED UPON A PUBLIC HEARING HELD ON NOVEMBER 3, 2003

This Report of the Hearing Panel regarding proposed amendments to the Pooling Plan for Market Milk is based on evidence received into the Department of Food and Agriculture's hearing folder. The folder includes the Departmental exhibits, written statements and comments received from interested parties, written and oral testimony received at a public hearing held November 3, 2003 and written post-hearing briefs received by November 7, 2003.

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Introduction

The Department held a public hearing on Monday, November 3, 2003 in Sacramento, to consider amendments to the Pooling Plan for Market Milk (Pooling Plan). The primary purpose was to hear testimony regarding the ability of handlers and of producer milk to leave the pool, termed “depooling”. The Department called the hearing after receiving a petition from the Alliance of Western Milk Producers, a dairy industry trade association that represents cooperatives. An alternative proposal was submitted by the Dairy Institute of California, a dairy industry trade association that represents dairy processors. On his own motion, the Secretary of Agriculture proposed a technical amendment to the Pooling Plan to address the methods used to make approximate payments on milk sold to handlers by producers.

Summary of Petition and Alternative Proposals:

The Alliance of Western Milk Producers

- Any plant that does not process Class 1 or mandatory Class 2 milk is designated a pool plant for an entire calendar year unless it notifies the Department otherwise by January 1.
- A non-pool plant which had previously been a pool plant is designated a non-pool plant unless it notifies the Department by January 1.
- Market milk pooled on January 1 must remain pooled for the entire year.
- Market milk delivered to a non-pool plant may not be pooled by any other plant prior to January 1.
- Remove from the Pooling Plan any references to use of prior month’s pool prices as an acceptable practice for making approximate payments to producers.

The Dairy Institute of California

- Any plant that does not process Class 1 or mandatory Class 2 milk may elect to change its status to a non-pool plant for a minimum of 12 consecutive months.
- Any non-pool plant may become a pool plant by meeting the requirements of a pool plant. Once the pool plant status has been attained, the plant may not elect to change its status until it has remained a pool plant for a minimum of 12 consecutive months.
- Supports the technical amendment to the Milk Pooling Plan proposed by the Department.
- Requests that language be added that mandates that the method used by any plant to make approximate payments to producers shall be consistent from month to month.

The Secretary of the Department of Food and Agriculture

- Proposed amendment to the Milk Pooling Plan allows plants making advanced payments to producer to use estimated pool prices rather than prior month’s pool prices.
- The estimation method for obtaining pool prices must be approved by the Pool Manager.

Hearing Witnesses:

A total of twelve witnesses testified including the Department's witnesses.

1. Cheryl Gilbertson — CDFA
2. Kristina Kreutzer — CDFA
3. Jim Tillison — Alliance of Western Milk Producers
4. William Schiek — Dairy Institute of California
5. Joe Heffington — California Dairies, Inc.
6. David Larsen — Imperial Valley Cheese
7. Joe E. Paris — Joseph Gallo Farms
8. Sharon Hale — Crystal Cream & Butter
9. Tiffany LaMendola — Western United Dairymen
10. James Gruebele — Land O' Lakes
11. Bob Feenstra — Milk Producers Council
12. Linda Lopes — California Dairy Women Association

In addition, a written submission was received from two persons who did not give oral testimony:

13. Rich Ghilarducci — Humboldt Creamery Association
14. Xavier Avila — California Dairy Campaign

Appendix 1 summarizes the testimony, written statements and post-hearing briefs. Appendix 2 summarizes the Panel's recommendation with arguments for and against its position.

We provide, in this report, analyses that were used to develop the Panel's recommendation. As with any analysis using historical data, we issue a caveat that the past is not necessarily a good predictor of the future.

Restricting Depooling Options

Issue

Current milk pooling regulations permit certain plants to exercise the option to depool on a monthly basis, that is, to not participate in the pool as pool plants. The relative price alignments that might signal a plant to consider depooling are not uncommon, nor are these alignments difficult to evaluate. A simple comparison of what the plant expects to pay into the pool relative to what the plant expects to receive from the pool in the form of a credit will suffice. Procedurally, depooling is not complicated. As of November 2003, any plant that would like to depool need only to notify the Milk Pooling Branch in advance of the month in which they wish to be depooled.

Even with these permissive rules, depooling is not widespread in California. Three regulations appear to limit the ability of plants to depool. First, the Milk Pooling Branch has historically treated cooperatives as pool plants. Second, minimum class prices apply to all plants that process Grade A milk. A plant that opts to depool must continue to pay producers the minimum class price(s) for the milk that it receives. Third, a producer who owns quota must ship to a pool plant within a 60-day period or be at risk for losing any quota owned. A few plants have shown the ability to comply with the requirements for a change in pool plant status and are not precluded from depooling by the three regulations. For these plants, depooling and repooling at the appropriate times can accrue financial benefits (see Analysis section for details).

The argument against depooling and subsequent repooling centers on equity. The plants that can change their pool status easily have the option of only participating in the pool when they can draw money from the pool. That is, when a plant's charge at minimum class prices is lower than its pool credit at quota and overbase prices. Conversely, the plants may choose not to participate in the pool (or depool) when class and pool prices are aligned such that the plant would have a net obligation payable to the pool.

Review of Proposed Changes

Two proposals recommended altering the ability of plants to depool. The Alliance of Western Milk Producers (Alliance) proposed that language be added to the Pooling Plan that would, in effect, curtail a plant's ability to depool. Under the Alliance's proposal, any plant that does not process Class 1 or mandatory Class 2 milk products shall be designated a pool plant for entire calendar year. A plant may change its status from a pool plant to a nonpool plant if it notifies the Department prior to January 1. Furthermore, a nonpool plant that had previously been a pool plant shall remain a nonpool plant unless it notifies the Department prior to January 1 of a change in status. In both cases, underlying notion is that a plant must adhere to its presumed status as a pool plant or its declared status as a nonpool plant for at least the calendar year.

The proposal advanced by the Alliance also suggests that language be added to the Pooling Plan to address the ability of producers to shunt milk from a pool plant to a nonpool plant. Ostensibly, such movements of milk might occur when class prices exceed the producer's expected pool prices. For example, if the Class 4b price exceeds the overbase price (what a non-quota holder would expect to receive for milk sold), then there is an incentive for the producer to ship to a nonpool plant. As

such, the producer who receives the Class 4b price directly would be better off, and the plant that is required to pay Class 4b price is indifferent. The Alliance seeks to discourage any opportunistic changes in farm milk shipments by mandating consistent treatment of the milk for the calendar year. Any market milk that was pooled as of January 1 would remain pooled for the entire year, and any market milk delivered to a nonpool plant would not be pooled by any other plant prior to January 1.

The Dairy Institute of California (Dairy Institute) submitted the only other proposal to address the depooling issue. The Dairy Institute proposal was also founded on the premise that manufacturing plants should not be able to depool and repool on a month-to-month basis, and permitting the practice creates inequities among plants. The Dairy Institute proposed language that may limit opportunistic depooling but in a less restrictive manner than the proposal advanced by the Alliance. Under the Dairy Institutes proposal, any plant that does not process Class 1 or mandatory Class 2 milk products may elect to change its pool status; a pool plant may become a nonpool plant, and vice versa. Any change in pool plant status must meet the requirements set forth in the Pooling Plan and adhered to for a minimum of twelve consecutive months. The Dairy Institute offered no proposal regarding the depooling of producer milk.

Analysis

Historical and Background Information

To review the extent of the practice and to provide a foundation for this section, the Panel presents some basic information on depooling in California. Since 1998, two plants have exercised the option to depool for economic reasons. Both were cheese plants with milk supplies coming directly from producers and not through milk marketing cooperatives. None of the producers supplying the two plants own any quota. When depooling has occurred, the total volume of milk taken out of the pool averages between 17 and 25 million pounds per month, or about 0.05% of the total milk production in California. The term, “depooling”, has been applied to producers, but such an application is awkward within the context of the regulation in the California dairy industry. The reason is that milk and/or plants are pooled or depooled, and not the producers themselves. The concept of plants depooling is straightforward; the concept of milk depooling is not as readily apparent. We offer these clarifying statements to distinguish between pool milk vis-à-vis nonpool milk. Current regulations specify that Grade A producer milk that is shipped to a pool plant or diverted by a pool plant to a non-pool plant is considered pool milk. Grade A producer milk that is shipped to a non-pool (or depooled) plant is considered non-pool (or depooled) milk

Decisions to Depool

The impact of depooling by cheese plants requires knowledge of class prices, pool prices and the volumes for milk components processed by month. In regard to the prices, the differences of Class 4b fat less overbase fat and of Class 4b SNF less overbase SNF are required. Four scenarios are possible, and each needs to be evaluated to determine the total impact of depooling. Consider Figure 1 that shows the four scenarios in the form of a decision table. The columns represent the “trigger” that cheese plants must evaluate before deciding to depool or not. The shaded quadrants indicate the instances in which price alignment and the decision to depool or not favor the plant. For example, the first column represents a scenario in which the Class 4b price is

higher than the overbase price. If faced with such a case, and the plant decides to participate in the pool, the advantage accrues to the pool. The reason is because, quite simply, the plant is paying more money into the pool in the form of minimum prices than the plant is able to draw from the pool in the form of a credit. If the plant decides, instead, to depool under the same price alignment scenario, then the advantage accrues to the plant. Again, the reason is readily apparent; the plant is paying less money into the pool in the form of minimum prices than the plant is able to draw from the pool in the form of a credit. The explanation of the other two quadrants follows the same approach.

Figure 2 reveals the impact of depooling on pool revenues using actual plant data from 1998 to 2003. The figures given in the decision table represent annual totals. In the upper left quadrant, a positive result suggests that the plant(s) participated in the pool even though the decision was

Figure 1. Decision Table for Plant Depooling.

	Class 4b - O/B = +	Class 4b - O/B = -
Plant participates in pool	Advantage to the pool	Advantage to the plant
Plant does not participate in pool	Advantage to the plant	Advantage to the pool

counter to what the economic signals indicated. In those months within any particular year, the plant(s) would have paid more money into the pool than they drew from the pool, giving a net benefit to the pool. Over the 1998 to 2003 time period, the plant(s) paid into the pool between \$0 and \$190,000 on an annual basis. In the lower left quadrant, a positive result suggests that the

plant(s) depooled and did not pay money into the pool, which is consistent with the economic signal. Over the 1998 to 2003 time period, the plant(s) kept between \$0 and \$1.25 million on an annual basis.

Figure 2. Results of Applying the Depooling Decision Table to Actual Plant Data, Range of Annual Totals from 1998 to 2003

	Class 4b - O/B = +	Class 4b - O/B = —
Plants participate in pool	<p>\$0 to \$190,000</p> <p>(plants were pooled when economic signals indicated they should not have been; money was paid into the pool)</p>	<p>\$0 to \$800,000</p> <p>(plants were pooled and drew money from the pool)</p>
Plants do not participate in pool	<p>\$0 to \$1,250,000</p> <p>(plants were not paying money into the pool; plants were depooled)</p>	<p>\$0 to \$2,150,000</p> <p>(plants were depooled when economic signals indicated they should have been in the pool; money was "left" in the pool)</p>

Looking at Runs

A cursory review of historic commodity price data shows that “runs” in prices, meaning consistently elevated prices for several consecutive months, are fairly common. Clearly, runs in the commodity markets are transmitted directly to the minimum class prices such that, in the specific case here, the Class 4b price could be consistently elevated for several months at a time. By their

nature, a run would suggest that a cheese plant could depool and avoid paying the Class 4b price into the pool in favor of paying the Class 4b price to its producers directly. Runs, coupled with a floating date for declaring pool status, could give a plant the flexibility to try to “beat the system”.

Possible runs were identified by taking those series of months in which Class 4b plants had an incentive to depool for more than one month. During the January 1998 to August 2003 period, three such runs were identified. Each run is twelve–months in duration:

- November 1998 to October 1999
- July 2001 to June 2002
- September 2002 to August 2003

Note that these runs do not overlap. That is, a cheese plant could have depooled for each of the three twelve–month periods. For this analysis, we assumed a milk processing capacity of 22 million pounds per month.

In the first of the three runs, five of the twelve–months favored depooling of Class 4b plants. In five of the other seven months, neither Class 4b nor Class 4a was given any signal to depool. In this run, a plant that depooled in November 1998 and stayed depooled until October 1999, would have not shared \$290,000 with the pool. Clearly, the “highs” in the cheese price were not negated by the “lows” during this period.

In the second of the three runs, the depooled plant would have faced a different situation. From July 2001 to June 2002, there was a clear signal for Class 4b to depool in only two of the months. In this run, a plant of the aforementioned size that declared depooled status would have lost nearly \$600,000 by not drawing money from the pool that the plant could have if it had stayed in the pool.

In the third run, the depooled plant would have, again, accrued benefits to itself. The decision to depool from September 2002 until August 2003 was the correct decision in four of the twelve–months. The plant would have kept large sums of money in months eleven and twelve; the price difference of Class 4b and overbase was \$1.54 and \$1.77 per hundredweight, respectively. These huge price differentials more than made up for the risk faced during the twelve–months. Again, a cheese plant that processed 22 million pounds of milk per month that declared depooled status would have not paid into the pool over \$500,000.

The elementary analysis shows that it is possible to declare depooled plant status and “beat the system” if the plant can float its declaration date. In sum total, these examples show that from January 1998 to present, a plant processing 22 million pounds of milk per year could have kept about \$200,000 from the pool simply by changing its pool status.

Discussion

Testimony from a myriad of dairy industry representatives supported overwhelmingly a change to the current manner in which plants may elect to become nonpool plants. All but one witness supported either the proposal submitted by the Alliance or that submitted by Dairy Institute. Even the witness that represented Imperial Valley Cheese, one of the two plants that has the ability to

depool easily, did not oppose the proposal submitted by the Alliance. Most of the witnesses that supported increased restrictions on the ability of plants to depool cited concerns about equity among plants and competitive advantages bestowed upon a select few.

The very notion of allowing only a select group of plants to depool in response to specific price alignments seems counter to the concept of pooling. One of the reasons that a statewide producer pool was implemented was to eliminate destructive and predatory trade practices. While opportunistic depooling in itself may not be characterized in that same light, it is nonetheless inherently damaging to the pool and to the producers who participate in the pool. The Panel agrees with the underlying sentiment voiced at the hearing — depooling and then subsequently repooling to take advantage of price alignments needs to be restricted.

The proposals advanced by the Alliance and Dairy Institute offer similar approaches to limiting depooling. The Alliance's proposal would instruct the Milk Pooling Branch to treat all plants that are not processing Class 1 or mandatory Class 2 products as pool plants unless the plants inform the Milk Pooling Branch differently. A nonpool plant that has previously been a pool plant would have to declare its intent to remain a nonpool plant by January 1 and adhere to that decision for the entire year. The Dairy Institute's proposal is slightly less restrictive. If implemented, their proposal would allow a plant to declare nonpool status at any point during the year so long as the plant remained out of the pool for at least twelve consecutive months.

The witness from the Dairy Institute submitted evidence in his testimony suggesting that the requirement to stay out of the pool for twelve consecutive months was sufficient to deter opportunistic depooling. The analysis was based on historic price data from 1995 to 2003. While he concluded that the expected value of depooling for twelve consecutive months was negative, the witness found that there were exceptions to this general rule. In other words, the imposition of a minimum twelve-month period for change in pool status with a floating declaration date would not have made depooling universally unattractive. In essence, a floating depooling declaration date may afford the plant the flexibility to gamble on the price differentials, and, at times, avoid sharing revenues with the pool. This finding is consistent with that of the Panel (see Analysis section).

Notwithstanding that finding, we believe that a change that follows the proposal submitted by the Dairy Institute will limit adequately opportunistic depooling by plants. By not specifying a depooling declaration date, such as January 1, the Panel maintains the internal consistency and intent of the language found within the Pooling Plan. The Panel recognizes that the changes proposed by the Alliance may address the depooling issue more directly. However, the Panel is sensitive to amending the Pooling Plan in a manner that will restrict a plant's ability to make long-term business decisions that may be completely unrelated to opportunistic depooling.

Finally, the Panel is compelled to address the issue of plant depooling and the ability of producers to associate with pool or nonpool plants. At first glance, the issue of depooling does not seem to involve decisions made by dairy producers directly. Implicit in this is the assumption that dairy producers engage in longer term contracts with processing plants, and the producers have limited ability to enter and to exit contracts easily. The witness from the Dairy Institute supported that view:

“It has been suggested that individual producers will seek to take advantage of pricing inversions by changing the handler to which they sell their milk. This would seem to be a very difficult task. Our understanding is that the majority of producer contracts with proprietary handlers are at least 12 months in length. It is doubtful that producers will be able to employ this method to ride the pool, by shipping to non-pool cheese plants when Class 4b prices are above the overbase price, and then shipping to pool plants when Class 4b prices are below the overbase price.”

The Panel agrees that the problem of producers entering and exiting contracts to obtain the desired plant association does not appear to be widespread. However, the pervasiveness of a potential loophole in regulations is not a criterion for addressing the issue itself; we point out that the problem of plant depooling is not widespread at this point, either. Moreover, the Panel is not convinced that the “standard” length of contracts between dairy producers and processors is alone sufficient to deter producers from seeking short-term contracts to get their milk pooled or depooled.

The Alliance’s proposal would address the issue of producers trying switch plant associations to improve their financial position. The proposal specifies that market milk pooled on January 1 of the calendar year remains pooled for the entire year, and market milk being delivered to a non-pool plant cannot be pooled by any other plant prior to January 1. The proposed amendments may very well be effective in preventing depooling and repooling of milk from a producer’s perspective. However, they would also seem to restrict any changes in milk movement patterns, some of which may be legitimate long-term business decisions by producers. A producer who would like to begin shipping milk to a nonpool plant after his or her contract expires with a pool plant mid-year would be enjoined from doing so.

The Panel asserts that a more flexible resolution to the problem of depooled producer milk can be reached without precluding efficient, logical and beneficial changes to milk movement patterns. Rather than requiring declarations for pool or nonpool status for a producer’s milk, the Panel recommends that the issue be addressed by modifying how the Milk Pooling Branch treats depooled and repooled producer milk. An explanation of the mechanics follows:

- A producer who has been shipping milk to a pool plant can begin shipping to a nonpool plant, and that milk will be depooled (excluded from the revenue pool).
 - If the producer had shipped milk to a pool plant for less than twelve months prior to shipping to a nonpool plant, then the nonpool plant will sustain the pool obligations for the milk.
 - The nonpool plant will be charged by the pool based on the usage of the milk and receive a credit for the milk at the overbase price for the remainder of the twelve months.
- The depooled milk can subsequently be repooled within a twelve-month period following the date of the milk being depooled but only by adhering to the following qualifying criteria.
 - The producer who wants to repool milk must have a contract with a handler who has direct Class 1 or mandatory Class 2 usage
 - The producer’s milk must be processed in the handler’s plant.

Similarly, the Panel addresses the case when nonpool milk attempts to enter the revenue pool:

- A producer who has been shipping all of his or her milk to a nonpool plant may begin shipping to a pool plant at any time.
 - If the producer had shipped milk to a nonpool plant for less than twelve months prior to shipping to a pool plant, then the pool plant will account to the pool as receiving milk from a nonpool source.
 - The plant will be charged by the pool based on in-plant usage and receive a credit at the plant's manufacturing percentages for the remainder of the twelve months.
- Any handler who purchases milk from that producer for the twelve months following a change from nonpool milk to pool milk will be charged by the pool based on in-plant usage and receive a credit for the milk at the overbase price.

Panel Recommendation for Restricting Depooling Options

The Panel recommends that any plant that does not process Class 1 or mandatory Class 2 milk products continue to have the option to change its pool status. However, any change in plant status, whether it be pool or nonpool, must be adhered to for a minimum of twelve consecutive months.

The Panel also recommends that depooling and repooling of producer milk to take advantage of price misalignments be curtailed by modifying the Milk Pooling Branch's treatment of such milk. In short, producer milk that has been depooled can only be repooled within a twelve-month period if it is physically shipped to a plant with Class 1 or mandatory Class 2 usage. Producer milk that was previously depooled and then pooled for less than twelve months can be purchased by nonpool plant; however, the plant will be charged by the pool based on the usage of the milk and receive a credit for the milk at the overbase price.

Estimation Procedures Used in Producer Payments

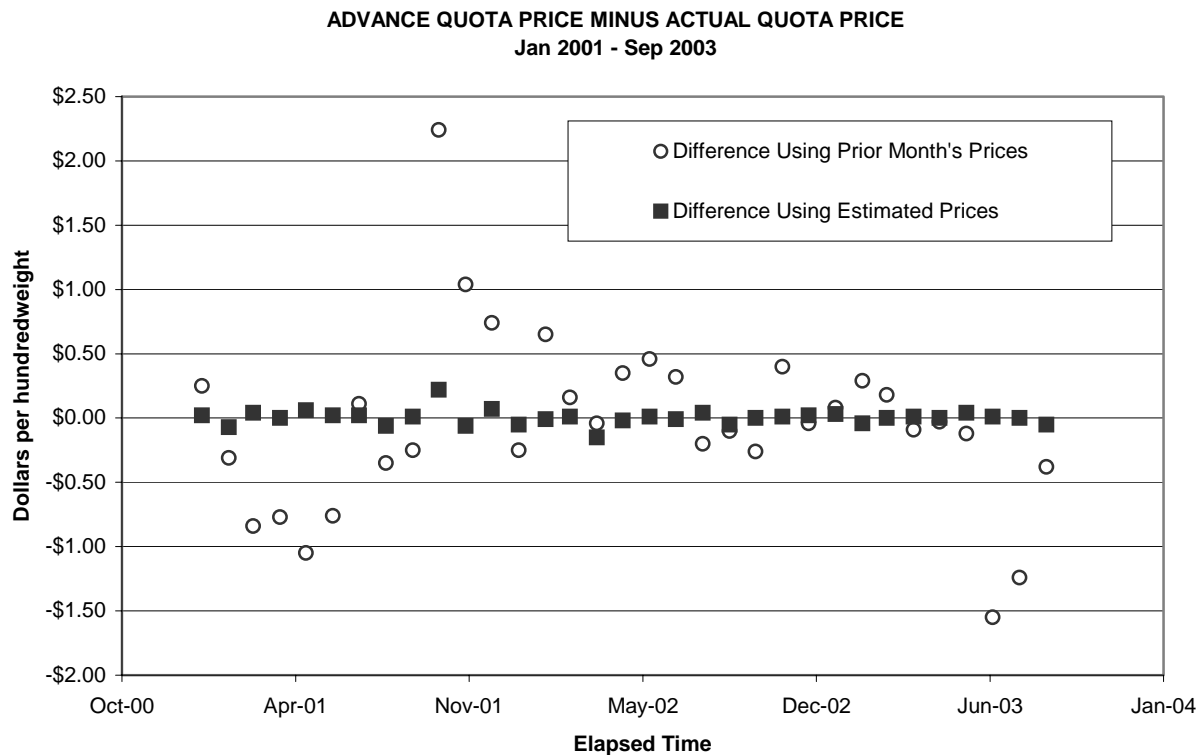
Issue

The Department brought forth a technical amendment to the Pooling Plan on its own initiative. The purpose is to address a producer payment issue that concerns consistency of the Pooling Plan with industry practices. The Pooling Plan currently specifies that proprietary plants will pay two approximate payments, for milk received in the current month from individual producers, followed by a final settlement payment to adjust to the actual pool prices when announced by the Department. The payment calculation method specified in the Pooling Plan requires that approximate payments be based on the prior month's pool prices.

Current Industry Practices

There are currently fifteen proprietary pool plants that pay independent producers directly. Of these, eight use prior month's prices, three use estimated prices, and four pay a fixed price that always exceeds the pool prices.

Plants that have adopted the practice of making approximate payments based on estimated prices contend that estimates more closely approximate the final pool price than prior month prices often do. At the hearing, the witness from Crystal Creamery submitted into the hearing record a comparison of actual prior month pool prices versus the prices determined through use of her



method for estimation. It should be noted that estimation method developed by this witness is essentially the same as used by other plants.

The chart clearly demonstrates that use of a price estimation method can allow a handler to make approximate payments that are significantly closer to actual market values of milk, than when prior month prices are used. The comparison of differences shows the increased level of disparity during periods of higher volatility in pool prices. The range of variance in this sample can certainly be considered significant, with a standard deviation of .058 for estimated prices, compared to .693 for the prior price method. This data clearly supports the proposition that the use of estimated prices can lead to less volatility and more predictability in making approximate payments, and explains the reason that many handlers and producers might prefer an estimated price payment procedure.

Some handlers have used estimated prices for many, perhaps twenty years now, with the implied approval of the Milk Pooling Branch. The Milk Pooling Branch became aware of the practice through industry requests to be allowed to estimate prices, reasoning that most of the market price data necessary for the estimation of the pool prices are available prior to the date by which advanced payments need to be made. Those handlers using estimated prices for approximate payments have submitted their methods to the Pool Manager for review, and have been subject to audit review and expression of opinion on the reasonability and proper implementation of their payment estimation procedures.

Analysis

The effect of using estimated pool prices has advantages in addressing several problems associated with the use of prior month's prices. First, producers are not as likely to be misled by preliminary monthly income levels, nor as disadvantaged by approximate payments that may be substantially less than the actual market value of their milk for the month. This is particularly significant in times when prices are quite volatile. Second, handlers are not placed in the undesirable situation of having to take back over-payments, when prices are on the decline, or when producers terminate their contracts. Further, if the producer actually goes out of business, the handler may not be able to recoup any overpayment.

Discussion

Testimony at the hearing by both processor and producer representatives were generally supportive of the Department's proposal. A few issues of concern were also raised and considered in examining possible payment abuses. One concern was in regard to consistency — that the plants might switch price estimation methods to their own benefit when one method withheld more funds from the producer than another method.

It was noted that plants typically contract with producers for terms of one year or longer, and it would be rare to find a contract written for a shorter duration. Business relations and good will between plant and producer are not likely to allow for shifting of payment methods, particularly if any such change affects either party negatively. In addition, the total amount of money due to each producer is ultimately required to be paid when the final pool prices are announced, and final payment is due by end of the month following the month that the milk was received.

Regarding the concern on consistent use of estimation procedures, consistency in use of any accounting procedure is expected and required in normal business practice. Additional assurance against payment abuse is that the Department regularly audits plants to assure that payment procedures meet Department approved estimation methods, adhere to Food and Agricultural Code requirements, and fulfill producer contractual agreements.

Another concern was that some producers would be treated differently than others, due to differences in price estimations among plants. As mentioned, plants using estimated prices are currently using essentially the same procedures, and any estimation methods must have the approval of the Pool Manager.

A hearing witness suggested that the Department actually calculate and announce an advance price estimate. The Panel is concerned that the Department might place itself at undue risk by offering an estimated price that a handler would rely on and perhaps subsequently incur financial loss due to excess approximate payments to producers that cannot be recouped. Another aspect to this discussion is that there does not appear to be a reason for the Department to offer or to insist upon a universally applied advance payment price. The Department would not gain any time savings to operations or audit personnel in the payment oversight functions, nor would there be a benefit in limiting the handlers' flexibility to establish individual price estimation procedures.

Some comments at the hearing suggested that the majority of the proprietary plants are currently using some form of estimated price payment procedure. In a post hearing brief, the Department submitted information that the majority of proprietary plants actually still use the prior month's prices for approximate payments. One reason stated for some plants continuing use of prior month prices appears to be related to the need for dedicated personnel with expertise to gather the necessary price information, to perform the calculations, and to explain the payment amounts to the producers. The Panel's position on continued use of prior month pricing is that it remains a valid method of making approximate payments, notwithstanding the recommendation to allow the use of price estimation methods.

The Panel feels that the proposed modifications to the Pooling Plan that would allow the use of estimated pool prices are long overdue. The Milk Pooling Branch has had ample time to review the effects of the changes, and has already implicitly approved the payment estimation procedures being used by many of the proprietary plants. The changes recommended would simply bring the language of the Pooling Plan into alignment with what is currently supported as standard and prudent practice in the industry. Key elements in implementing the proposal are to assure that any procedure for estimating prices for producer payments is approved by the Pool Manager and is applied on a consistent basis.

Panel Recommendation for Estimation Procedures Used in Producer Payments

The Panel recommends that the Pooling Plan be amended to allow handlers to use price estimation procedures for approximate payments to producers that have been reviewed and approved by the Pool Manager as an alternative to using prior month's pool prices.

Appendix 1
Summary of Testimony and Post Hearing Briefs

ALLIANCE OF WESTERN MILK PRODUCERS

- Any plant that does not process Class 1 or mandatory Class 2 milk should be designated a pool plant for an entire calendar year unless it notifies the Department by January 1 of a change in plant status.
- A plant with non-pool status which previously had been a pool plant should be continue to be designated a non-pool plant unless it notifies the Department by January 1.
- Market milk pooled on January 1 should remain pooled for the entire year.
- Market milk delivered to a non-pool plant should not be pooled by any other plant prior to January 1.
- Had the proposal been in place since 2000, would have put an additional \$1.33 million into the pool.
- Opposes Dairy Institute's proposal because the floating declaration date gives a plant a chance to gamble on depooling for twelve months.
- Compared the depooling declaration with that required of producer's regarding Grade A or Grade B status; both the proposal and the Grade A/B declaration use the January 1 deadline.
- Remove from the Pooling Plan any references to use of prior month's pool prices as an acceptable practice for making advanced payments to producers.

DAIRY INSTITUTE OF CALIFORNIA

- Manufacturing plants should not be able to depool and repool on a month-to-month basis.
- Any plant that does not process Class 1 or mandatory Class 2 milk may elect to change its status to a non-pool plant, but the change in status must apply for a minimum of twelve consecutive months.
- Any non-pool plant may change its status to that of a pool plant by meeting the requirements of a pool plant. Once the pool plant status has been attained, the plant may not elect to change its status until it has remained a pool plant for a minimum of 12 consecutive months.
- Alliance's proposal is overly restrictive.
- The possibility of a plant losing money during the twelve month period should be sufficient to deter any rational, risk-averse, profit-maximizing cheese plant from depooling.
- Producers would have a difficult time entering and exiting contracts to take advantage of a pool plant's status or a nonpool plant's status.
- Contracts are generally in place for twelve months or more.
- Individual producer depooling does not need to be addressed with regulations as long as the plant depooling issue is remedied.
- Supports the technical amendment to the Milk Pooling Plan proposed by the Department.
- Requests that language be added that mandates that the method used by any plant to make advanced payments to producers shall be consistent from month to month.

CALIFORNIA DAIRIES, INC.

- No justification for allowing nonpool plants the ability to jump in and out of the pool based on strictly economic reasons.
- Supports the proposal advanced by the Alliance.
- Supports the technical amendment to the Pooling Plan regarding producer payments.
- Department should continue to review producer payments to assure that the method chosen by plants is applied consistently.

IMPERIAL VALLEY CHEESE

- Have used the ability to depool or to pool milk in order to return a higher milk price to the dairy producer who supplies the plant.
- Not opposed to the proposal advanced by the Alliance.
- Does not support retroactive application of any amendment made to the Pooling Plan.

JOSEPH GALLO FARMS

- Opposed to the proposals advanced by the Alliance and by the Dairy Institute.
- The ability of some plants to depool has been in place as long as the milk pooling program has been operating.
- The amount of milk that has depooled is a mere fraction of total California milk production.
- The proposal by the Alliance is not well written and leaves too much room for interpretation.
- No changes to the Pooling Plan are necessary regarding the ability of plants not processing Class 1 or mandatory Class 2 products to depool.
- Gallo Farms has supported the system by sending significant volumes of milk to Class 1 plants every month.
- Supports the technical amendment proposed by the Department regarding producer payments.

CRYSTAL BUTTER AND CREAM

- Supports the proposal advanced by the Dairy Institute regarding depooling.
- Supports the technical amendment proposed by the Department regarding producer payments.

WESTERN UNITED DAIRYMEN

- Supports the proposal advanced by the Alliance regarding depooling of plants and of producer milk.
- Proposal is consistent with the intent of pooling.
- Depooling is a large issue in federal orders, although not as significant a problem in California.
- Plants that can depool have significant competitive advantages over those that cannot.
- Supports the technical amendment proposed by the Department regarding producer payments.

LAND O'LAKES

- Supports the proposal advanced by the Dairy Institute regarding depooling.
- Depooling in federal orders gives a distinct advantage to plants operating within those markets.
- Cooperatives do not have the ability to depool.

CALIFORNIA DAIRY WOMEN ASSOCIATION

- Plants should not be allowed to depool for the purpose of taking advantage of short-term pricing changes.
- Supports the proposal advanced by the Alliance regarding depooling.

CALIFORNIA DAIRY CAMPAIGN

- Supports the proposal advanced by the Alliance regarding depooling.
- Producer prices have been low for more than 20 months. If not for the pooling system, prices to producer would have been even lower.

HUMBOLDT CREAMERY ASSOCIATION

- Supports the proposal advanced by the Alliance regarding depooling.
- Supports the technical amendment proposed by the Department regarding producer payments.

Appendix 2
Summary of Panel Recommendation

The Panel recommends that:

- Any plant that does not process Class 1 or mandatory Class 2 milk products continue to have the option to change its pool status. However, any change in plant status, whether it be pool or nonpool, must be adhered to for a minimum of twelve consecutive months.
- Any milk that has been depooled can only be repooled within a twelve-month period if it is physically shipped to a plant with Class 1 or mandatory Class 2 usage. A plant that purchases milk that was previously depooled and then pooled for less than twelve months will be charged by the pool based on the usage of the milk and receive a credit for the milk at the overbase price.
- Handlers be allowed to use price estimation procedures for approximate payments to producers that have been reviewed and approved by the Pool Manager as alternative to using prior month's pool prices.

Arguments in Favor of Panel Recommendations

- Restricting plant depooling and subsequent repooling will restore equity among plants, is consistent with the concept of pooling, and may provide increased revenues to the pool.
- Discouraging producers from shifting their associations with pool or nonpool plants for short term financial gains is consistent with the concept of pooling and may provide increased revenues to the pool.
- Allowing plants to use a price estimation procedure for approximate payments to producers instead of the previous month's pool prices is consistent with industry practices and minimizes price risk for both producers and processors.

Arguments Opposed to Panel Recommendations

- Depooling by plants has been permitted since the inception of milk pooling in California and represents a very small percentage of total milk production.
- Addressing plant depooling and depooled producer milk requires more regulation by the Department of Food and Agriculture.
- Allowing plants to use a variety of price estimation procedures for approximate payments to producers does not assure that the methods are used consistently. A plant may be able to select a different procedure from month-to-month, and the infractions would not be detectable until well after-the-fact.